



## COMMERCE COMMISSION

### Decision No. 488

Determination pursuant to the Commerce Act 1986 in the matter of an application for clearance of a business acquisition involving:

**THE GRIBBLES GROUP LIMITED**

**and**

**ALPHA SCIENTIFIC LIMITED**

**The Commission:** John Belgrave  
Denese Bates  
Peter JM Taylor

**Summary of Application:** The acquisition by the Gribbles Group Limited or one of its interconnected bodies corporate of up to 100% of the shares in, or assets of, Alpha Scientific Limited.

**Determination:** Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition.

**Date of Determination:** 4 February 2003

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BRACKETS**

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## THE PROPOSAL

1. On the 20 November 2002 the Gribbles Group Limited registered a notice with the Commission seeking clearance under s66(1) of the Commerce Act 1986 for the proposed acquisition of the business and business assets of Alpha Scientific Ltd.
2. Gribbles is an Australian firm which specialises in food microbiology and veterinary diagnostic pathology. Alpha Scientific is a privately owned diagnostic laboratory based in the Waikato which specialises in veterinary diagnostic pathology and food microbiology. Alpha scientific is not involved in human pathology.

## THE PROCEDURES

3. Section 66(3) of the Act requires the Commission either to clear or to decline to clear a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was sought by the Commission and agreed to by the applicant. Accordingly, a decision on the application was required by 5 February 2003.
4. In its application, Gribbles sought confidentiality for specific aspects of the application. A confidentiality order was made in respect of the information for a period of 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.
5. The Commission's determination is based on an investigation conducted by staff.
6. The Commission's approach is based on principles set out in the Commission's *Practice Note 4*.<sup>1</sup>

## THE PARTIES

### The Gribbles Group Limited (Gribbles)

7. The Gribbles Group Limited is Australian owned and involved in human and animal pathology testing, radiology, and analytical analysis including industrial & environmental testing. Gribbles pathology has grown to become one of the largest veterinary pathologists in Australia, with 25 laboratories and over 1000 staff.
8. In New Zealand, Gribbles have six laboratories. These are in Auckland, Waikato, Palmerston North, Christchurch, Lincoln, and Dunedin, including Labworks in Christchurch.
9. Gribbles also operate in Malaysia with 14 Laboratories and over 350 staff and recently announced a joint venture to set up laboratories in India.

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<sup>1</sup> Commerce Commission, *Practice note 4: The Commission's Approach to Adjudicating on Business Acquisitions Under the Changed Threshold in section 47 – A Test of Substantially Lessening Competition*, May 2001.

### **Alpha Scientific Limited (Alpha)**

10. Alpha was created in 1995 by four pathologists previously employed in the Government research lab, Ruakura. It has a staff of 61, including eight veterinary pathologists, forty-two qualified scientists and technicians, and eleven administrative and support staff. Alpha have a single laboratory in Hamilton.
11. Alpha Scientific is a leading provider of laboratory services in New Zealand, specialising in animal health and food safety. It's services include:
- Veterinary diagnostic and pathology services;
  - Food and water testing;
  - Plant nutrition analysis;
  - Veterinary "Point of Care Testing" support; and
  - Veterinary supplies.

### **OTHER RELEVANT PARTIES**

#### **Waikato Veterinary Laboratories Limited (Waikato Vet Labs)**

12. Waikato Vet Labs is based in Hamilton and offer veterinary diagnostic pathology services. [

]

#### **Northland Veterinary Laboratories Limited (Northland Vet Labs)**

13. Northland Vet Labs is based in Whangarei and operated by two laboratory technicians. It specialises in parasite work, drench work, and veterinary testing. [

]

#### **Idexx Limited (Idexx)**

14. Idexx is a large Australian veterinary pathology company which is also New Zealand's main supplier of veterinary in-clinic analysers. While Idexx does not currently operate laboratories in New Zealand, it has an established presence through the sale of its self testing machines. [

]

#### **Human Health Labs**

15. Human Health labs include the franchised chain Med Lab. These labs specialise in the testing of human samples using the same machines and techniques as veterinary labs. Because of this, human health labs can, and do, undertake some veterinary lab work. When it comes to more specialised veterinary work, such as histo-pathology, human labs need trained veterinary pathologists to read the animal samples. The following human health labs already provide a small amount of veterinary diagnostic pathology:

- Sonic Group
- Southern Communities
- Bay of Plenty Vet Lab
- Northland Med Lab
- Taranaki Med Lab

16. However, this is only as a very small portion of their business (less than 10%) and therefore no specific information on these organizations is presented.

### **MAF**

17. The Ministry of Agriculture and Fisheries (MAF) is responsible for disease monitoring and control of livestock in New Zealand. This requires information collection and some veterinary diagnostic pathology. MAF currently spend [ ] per annum on these services. [ ] of this is spent on information collection, the remaining [ ] is spent on veterinary diagnostic pathology. This is purchased from both Alpha and Gribbles.

### **Animal Health Board**

18. The Animal Health Board (AHB) is an incorporated society which receives government funding as the designated management agency used to undertake functions in the Bio Security Act. The AHB is a large purchaser of veterinary pathology diagnostic services [ ]

19. The AHB also contracts a significant portion of work, over and above this, to AgResearch, in the information collection area. Most of this work is research-based blood testing which is not currently undertaken by either Alpha or Gribbles. Technically, should the work be tendered, a veterinary pathology lab could carry out the work.

### **The New Zealand Veterinary Association**

20. The New Zealand Veterinary Association (NZVA) was established in 1923 and provides advocacy/information services to its members. Almost all of New Zealand's 300 vets are members of the NZVA. [ ]

### **Massey University**

21. Massey University have a veterinary training school in Palmerston North. This school does not train veterinary pathologists, however, it does have a veterinary pathology lab and employs veterinary pathologists. Veterinary pathologists from Massey University have been available in the past for casual veterinary pathology work. [ ]

## INDUSTRY BACKGROUND

22. The services offered by human/veterinary laboratories to the medical and veterinary practitioners are essentially the same. Whether human or animal, pathology services can be broken down into the following categories:
- **Haematology** -the quantification and in some cases morphological assessment of blood cells and clotting factors from the live animal
  - **Clinical biochemistry** -the quantification of enzymes, other proteins and biological chemical components of the fluid fraction of the blood
  - **Trace element and nutritional chemistry** -quantification of chemicals and minerals in the blood or body tissues related to performance and production
  - **Endocrinology** -quantification of hormone agents in the blood or body secretions
  - **Microbiology** -the culture and identification of bacteria and fungi from samples of biological or inert material
  - **Histopathology** -the study of and diagnosis of disease processes by examination of microscopic sections of body parts
  - **Necropsy** -dissection and examination of the dead body or body parts at a gross visual level with aim to make diagnosis of disease processes
  - **Serology** -using body fluids, mostly blood, to quantify and identify immune responses indicative of the state of disease or immunity of the animal.
  - **Parasitology** -study of the identity and presence of parasites-mostly multicellular ones in the body
  - **Toxicology** -chemical analysis of body parts or gastrointestinal content for toxic compounds or assessment of gastrointestinal content for known poisonous plants
  - **Cytology** -assessment of body fluids and secretions as well as small samples of cells from the live animal for disease indications. This includes a microscopic assessment visually as well as a quantification by machinery for cell numbers, protein levels etc.
23. Human pathology laboratories supply testing services to the veterinary market across the broad range of these testing parameters, with the exception of necropsy which constitutes less than 1% of total veterinary market revenue.
24. In-clinic veterinary analysers have captured a proportion of the veterinary haematology and biochemistry testing work. Clinics own or rent the machines to analyse their own samples and then either do their own interpretation to reach diagnosis or send the results to veterinary pathologists for interpretation, which can be done electronically to internationally based veterinary pathologists.
25. Labworks was an independent veterinary pathology lab, which is now owned by Gribbles. Labworks is known to have supplied an interpretative service to vets by emailing quantified data and the clinical examination notes to veterinary pathologists based in California. Alpha Scientific also supplies such an “off-shore” pathology service to clients in Australia as required. Serology testing can also be covered by test kits available from companies such as Idexx.
26. Histopathology is the only field where it is essential that a veterinary pathologist be used for interpretative assessment. Sample preparation can be undertaken at any human

pathology lab. This part of the market would represent no more than 5% of the total veterinary pathology market revenue.

27. Customers in the market are mainly diffuse with small on-going purchases rather than large one-off contracts. Customer relations, reputation, and quality of service typically play more important roles in the industry than binding contracts. Customers tend to purchase services from a wide range of different sources on a day to day basis.

## MARKET DEFINITION

28. The Act defines a **market** as:

*... a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.*

29. For the purpose of competition analysis, a relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of entry, could impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the ‘*ssnip* test’). For the purpose of determining relevant markets, the Commission will generally consider a *ssnip* to involve a five percent increase in price for a period of one year.
30. It is substitutability at competitive market prices which is relevant in defining markets. Where the Commission considers that prices in a given market are significantly different from competitive levels, it may be necessary for it to assess the effect of a *ssnip* imposed upon competitive price levels, rather than upon actual prices, in order to detect relevant substitutes.
31. The Commission will seek to define relevant markets in terms of four characteristics or dimensions:
- the goods or services supplied and purchased (the product dimension);
  - the level in the production or distribution chain (the functional level);
  - the geographic area from which the goods or services are obtained, or within which the goods or services are supplied (the geographic extent); and
  - the temporal dimension of the market, if relevant (the timeframe).
32. The Commission will seek to define relevant markets in a way that best assists the analysis of the competitive impact of the acquisition under consideration. A relevant market will ultimately be determined, in the words of the Act, as a matter of fact and commercial common sense.
33. Where markets are difficult to define precisely, the Commission will initially take a conservative approach. If the proposed acquisition can be cleared on the basis of a narrow market definition, it would also be cleared using a broader one. If the Commission is unable to clear the proposed acquisition on the basis of the narrower market, it will be necessary to review the arguments and evidence in relation to broader markets.

## Product Dimension

34. The delineation of relevant markets as a basis for assessing the competitive effects of a business acquisition begins with an examination of the goods or services offered by each



of the parties to the acquisition. Both demand-side and supply-side factors are generally considered in defining market boundaries. Broadly speaking, a market includes products that are close substitutes in buyers eyes on the demand-side, and suppliers who produce, or are able easily to substitute to produce, those products on the supply-side.

35. The Commission takes the view that the appropriate time period for assessing substitution possibilities is the longer term, but within the foreseeable future.<sup>2</sup> The Commission considers this to be a period of one year, which is the period customarily used internationally in applying the ‘ssnip’ test (see below) to determine market boundaries. The Commission will take into account recent, and likely future, changes in products, relative prices and production technology in the process of market definition.
36. Alpha and Gribbles both offer veterinary diagnostic pathology and food microbiology services. Aggregation in the food microbiology market post the proposed acquisition would be minimal and there are a large number of competitors. Therefore, this market is not considered further.
37. The Commission considers all of the market segments noted in the list above to be part of the same veterinary diagnostic pathology market. However, the Commission notes that there are special characteristics of some segments which make them unique. For instance, veterinary histo-pathology work needs to be overseen by a trained veterinary pathologist.
38. Both Alpha and Gribbles operate in the veterinary diagnostic pathology market. Should the acquisition proceed, [ ] aggregation will occur in this market. Therefore, in order to take the most conservative approach, competition analysis will focus on the veterinary diagnostic pathology market.

#### *Demand-side substitution*

39. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative prices.
40. Initially, markets are defined for each product supplied by two or more of the parties to an acquisition. Unequivocal substitutes are combined. For each initial market so defined, the Commission will examine whether the imposition of a snip would be likely to be profitable for the hypothetical monopolist. If it were, then all of the relevant substitutes must be incorporated in the market. If not, then the next most likely substitute good or service will be added to the initial market definition and the test repeated. This process continues until a combination of products is found which defines the product dimension of a relevant market, namely, the smallest combination of goods or services for which a snip would be profitable.

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<sup>2</sup> In *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [ ] 2 NZLR 351 Smellie J and the Court of Appeal on appeal approvingly quoted an earlier decision of the Commerce Commission in *Edmonds Food Ind Ltd v W F Tucker & Co Ltd* (Decision 21, June 1984) where the Commission had ruled: “A market has been defined as a field of actual or potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive”. See also *News Limited v Australian Rugby Football League Limited & Ors* (1996) ATPR at 41,687, where Burchett J stated: “Long term prospects that can be more or less clearly foreseen are, to that extent, a present reality, from the point of view of identifying the constraints upon commercial action. This fact emphasises the importance of the principle . . . that substitution possibilities in the longer run may be very significant for market delineation.” Also *Re Tooth & Co Ltd v Tooheys Ltd* (1979) 39 FLR 1 emphasises longer run substitution possibilities.

41. On the demand-side, the technical viability of one good or service as a substitute for another must be assessed. However, even where another product may technically be suitable as an alternative for the product in question, its price may be so much higher that it may be a poor substitute in an economic sense, at least for the great majority of buyers. In judging economic substitutability between products, the Commission will have regard to relative prices, quality and performance when assessing whether they are, in fact, close substitutes in the eyes of buyers.
42. Those supplying veterinary diagnostic pathology services rely on high volumes to make a profit from tests. Given the options of customers to reduce demand for tests, it is unlikely that any firm would be in a position to increase prices. For example, industry participants inform the Commission that self diagnosis of animals is used by farmers on a day to day basis, particularly when the disease has occurred in the past and is easily recognised. Many of the tests used by farmers are used to test livestock productivity. The amount of this type of testing is a function of the value of the animal, the success of the farm that year, and the price of the test. Farmers will typically avoid these tests if the price is too high relative to the value of the information conveyed. These tests are even more price elastic than disease diagnosis tests. Self diagnosis of animals increases when there is a down turn in the farming sector and may increase should prices increase.
43. Around 30% of all veterinary clinics have in-clinic analysers. These machines are used for basic blood testing and cost around \$20,000. An increasing number of veterinarians are purchasing these machines.
44. Industry participants estimate that around 30% of the veterinary pathology work can be substituted via these means should conditions dictate. That is, when prices for laboratory tests are high, more self diagnosis and in-clinic analysers will be used.

#### *Supply-side substitution*

45. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change in their relative prices.
46. In its application, the applicant submits that human pathology labs are near entrants to the veterinary diagnostic pathology market. Human pathology labs contacted by the Commission confirmed that this was technically accurate. The equipment used to test human and animal samples is exactly the same. Animal and human samples can therefore be run through the same machines. For around 20% of the work, a veterinary pathologist is required to interpret the results. Human labs can employ such a pathologist or have those samples read by a veterinary pathologist working elsewhere.
47. Most human pathology labs contacted by the Commission have no plans to enter the market due to low volumes and the small size of the veterinary pathology market; the human pathology labs contacted by Commission staff indicated that they did not have plans to establish a larger presence in the veterinary diagnostic pathology market. All indicated that they would continue to evaluate this in the future.
48. The Commission is aware that at least one firm has plans to enter the veterinary diagnostic pathology market. This is discussed later in this report.

### *Undifferentiated/Differentiated Products*

49. In some instances, market definitional problems arise because of the differentiated nature of the goods or services involved in a business acquisition, caused by differing technical specifications, branding, packaging, warranties, distribution channels and other factors.
50. Where a significant group of buyers within a relevant market is likely to be subject to price discrimination, the Commission will consider defining additional relevant markets based on particular uses for a good or service, particular groups of buyers, or buyers in particular geographic areas. In other cases, the primary focus may switch to the extent to which a business acquisition eliminates competition between the products brought together by the acquisition.
51. In terms of veterinary pathology, the services offered by Gribbles and Alpha are much the same. Differentiation can be found in terms of level of service, including speed of results and the quality of interpretive comments.
52. The Commission therefore concludes that for the purpose of assessing the competition implications of the proposed acquisition, the appropriate product market is the veterinary pathology diagnostic market.

### **Geographic Extent**

53. The Commission will seek to define the geographical extent of a market to include all of the relevant spatially dispersed sources of supply to which buyers can turn should the prices of local sources of supply be raised. For each good or service combination, the overlapping geographic areas in which the parties operate are identified. These form initial markets to which a ssnip is applied. Additional geographic regions are added until the smallest area is determined within which the hypothetical monopolist could profitably impose a ssnip.
54. Generally, the higher the value of the product to be purchased, in absolute terms or relative to total buyer expenditure as appropriate, the more likely are buyers to travel and shop around for the best buy, and the wider the geographic extent of the market is likely to be.
55. Where transport costs are high relative to the final value of a product, a narrower geographic market is more likely to be appropriate. Where product perishability and other similar practical considerations limit the distance that a product may be transported, this may limit the geographic extent of the market. The timeliness of delivery from alternative geographic sources is similarly relevant.
56. Although buyers and sellers of a particular good or service may interact in markets that are apparently local or regional in extent, those markets may themselves overlap and interrelate so as to form a market covering a larger geographical area. In these situations, the larger market is likely to be the appropriate one for analysing the competitive effects of a business acquisition.
57. The Commerce Act defines a market to be a “market in New Zealand”. However, in many markets New Zealand buyers purchase products from both domestic and from overseas suppliers. Where imported products are close substitutes for domestic products, the overseas suppliers will be part of the relevant market. In such circumstances the Commission, in order to comply with the wording of the Act, is likely to define a national market and then, as discussed later in the competition analysis, to consider the extent to which overseas suppliers exercise a competitive constraint on the participants in the domestic market.

58. Access to efficient couriers means that veterinary pathology samples are frequently sent throughout New Zealand. This means that customers can use a variety of laboratories to undertake a range of tests. While those regions which have a local lab will tend to use it, competing labs on other areas of the country can successfully target customers in other regions through tools such as free courier services. Alpha for example, has no physical presence in the South Island but currently has a number of South Island customers. The Commission therefore defines the New Zealand market for veterinary diagnostic pathology as a national market.

### **Functional Extent**

59. The production, distribution and sale of a product typically occurs through a series of functional levels – for example, the manufacturing/import level, the wholesale/distribution level and the retail level. It is often useful to identify the relevant functional level in describing a market, as a proposed business acquisition may affect one horizontal level, but not others. Alternatively, some acquisitions, such as those involving businesses at different vertical levels, may raise issues related to vertical integration. Generally the Commission will seek to identify separate relevant markets at each functional level affected by an acquisition and assess the impact of the acquisition on each.
60. In this market there is only one functional level. The major sources of supply of veterinary diagnostic pathology services in New Zealand are the services supplied by Alpha and the services supplied by Gribbles, along with in-clinic veterinary analysers and the range of tests supplied by some human pathology labs.
61. Therefore, the Commission concludes that the functional level affected by this acquisition is the supply of veterinary diagnostic pathology services.

### **Conclusion on Market Definition**

62. The Commission concludes that the relevant market is the New Zealand market for the supply of veterinary diagnostic pathology services.

## **COMPETITION ANALYSIS**

63. The Act prohibits business acquisitions that would be likely to have the effect of substantially lessening competition in a market. The Commission makes this assessment against a counterfactual of what it considers would be likely to happen in the absence of the acquisition. A substantial lessening of competition is taken to be equivalent to a substantial increase in market power. A business acquisition can lead to an increase in market power by providing scope either for the combined entity to exercise such power unilaterally, or for the firms remaining in the market to co-ordinate their behaviour so as to exercise such power.

### **Substantially Lessening Competition**

64. Section 47 of the Act prohibits particular business acquisitions. It provides that:
- A person must not acquire assets of a business or shares if the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market.

65. Section 2(1A) provides that substantial means “real or of substance”. Substantial is taken as meaning something more than insubstantial or nominal. It is a question of degree.<sup>3</sup> What is required is a real lessening of competition that is not minimal. The lessening needs to be of such size, character and importance to make it worthy of consideration.<sup>4</sup>
66. Section 3(2) provides that references to the lessening of competition include references to the hindering or preventing of competition.<sup>5</sup>
67. While the Act defines the words “substantial” and “lessening” individually it is desirable to consider the phrase as a whole. For each relevant market, the Commission will assess:
- the probable nature and extent of competition that would exist in a significant section of the market, but for the acquisition (the counterfactual);
  - the nature and extent of the contemplated lessening; and
  - whether the contemplated lessening is substantial.<sup>6</sup>
68. In interpreting the phrase “substantially lessening competition”, the Commission will take into account the explanatory memorandum to the Commerce Amendment Bill (No 2). The memorandum notes that:
- Two of the 3 key prohibitions are strengthened to bring New Zealand into line with Australian competition law, which will facilitate a more economic approach to defining anti-competitive behaviour.
- and, in relation to s47:
- This proposed new threshold is the same as the threshold for these types of acquisitions in section 50 of the Trade Practices Act 1974 (Australia).
69. For the purposes of the analysis, the Commission takes the view that a lessening of competition and a strengthening of market power may be taken as being equivalent, since they are the two sides of the same coin. Hence, it uses the two terms interchangeably. Thus, in considering whether the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market, the Commission will take account of the scope for the exercise of market power, either unilaterally or through co-ordination between firms.
70. When the impact of enhanced market power is expected predominantly to be upon price, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and able to be sustained for a period of at least two years, for the lessening, or likely lessening, of competition to be regarded as substantial. Similarly, when the impact of increased market power is felt in terms of the non-price dimensions of competition, these also have to be both material and able to be sustainable for at least two years for there to be a substantial lessening, or likely substantial lessening, of competition.

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<sup>3</sup> *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406, 434; *Mobil Oil Corporation v The Queen in Right of NZ* 4/5/89, International Centre for Settlement of Investment Disputes, Washington DC, International Arbitral Tribunal ARB/87/2 (paras 8.2, 19, 20).

<sup>4</sup> *Dandy Power Equipment Ltd v Mercury Marina Pty Ltd* (1982) ATPR 40-315, 43-888; *South Yorkshire Transport Ltd v Monopolies & Mergers Commission* [ ] 1 All ER 289.

<sup>5</sup> For a discussion of the definition see *Commerce Commission v Port Nelson Ltd*, supra n 6, 434.

<sup>6</sup> See *Dandy*, supra n 5, pp 43–887 to 43-888 and adopted in New Zealand: *ARA v Mutual Rental Cars* [ ] 2 NZLR 647; *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [ ] 2 NZLR 352; *Fisher & Paykel Ltd v Commerce Commission* [ ] 2 NZLR 731; *Commerce Commission v Carter Holt Harvey*, unreported, High Court, Auckland, CL 27/95, 18/4/00.

## The Counterfactual

71. The Commission uses a forward-looking, counterfactual, type of analysis in its assessment of business acquisitions, in which two future scenarios are postulated: that with the acquisition in question, and that in the absence of the acquisition (the counterfactual). The impact of the acquisition on competition can then be viewed as the difference between those two scenarios. It should be noted that the status quo cannot necessarily be assumed to continue in the absence of the acquisition, although that may often be the case. For example, in some instances a clearly developing trend may be evident in the market, in which case the appropriate counterfactual may be based on an extrapolation of that trend.
72. The present state of competition in a market can be referred to in order to illuminate the future state of the market where there is a range of possible scenarios should a merger not proceed.<sup>7</sup>
73. [ ]  
Should the acquisition not proceed, it is likely that another independent firm will purchase Alpha and continue to operate in the veterinary pathology diagnosis market. [ ]
74. The Commission therefore proposes to adopt as a counterfactual, the continued presence of Alpha as a firm independent of Gribbles either alone or part of another firm.

## Potential Sources of Market Power

75. Two types of market situation conducive to the exercise of substantial unilateral market power are now considered. These involve making the distinction between undifferentiated and differentiated product markets. That distinction may also have a bearing on the scope for co-ordinated behaviour in a market.
76. As previously noted, the veterinary pathology diagnosis market involves largely undifferentiated products.
77. Consequently, the Commission has focused on the extent to which rivals can expand supply to constrain any output restriction and raising of price by the merged entity.
78. In broad terms, a substantial lessening of competition cannot arise from a business acquisition where there are sufficient competitive constraints upon the combined entity. The balance of this decision considers and evaluates the constraints that might apply in the New Zealand veterinary pathology market under the following headings:
- existing competition;
  - potential competition from entry; and
  - other competition factors.

## ANALYSIS OF EXISTING COMPETITION

79. One consequence of a merger between competitors is that the number of firms competing in a market is reduced or, put another way, concentration is increased. This raises the possibility that competition in the market may be substantially lessened through the

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<sup>7</sup> *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* (2000) ATPR 41 at paras 113 & 114.

exercise of unilateral or coordinated market power. These are the subject of the analysis in this section.

## **Scope for Unilateral Market Power**

### *Introduction*

80. An examination of concentration in a market post-acquisition can provide a useful guide to the constraints that market participants may place upon each other, including the combined entity. Both structural and behavioural factors have to be considered. However, concentration is only one of a number of factors to be considered in the assessment of competition in a market. Those other factors are considered in later sections, as noted above.
81. Market shares can be measured in terms of revenues, volumes of goods sold, production capacities or inputs (such as labour or capital) used. All measures may yield similar results in some cases. Where they do not, the Commission may, for the purposes of its assessment, adopt the measure which yields the highest level of market share for the combined entity. The Commission considers that this will lead to an appropriately conservative assessment of concentration, and that the factors which lead to the other different market share results are more appropriately considered elsewhere during the assessment of the acquisition.<sup>8</sup>
82. In determining market shares, the Commission will take into account the existing participants (including ‘near entrants’), inter-firm relationships, and the level of imports. This is followed by a specification of the Commission’s ‘safe harbours’, an estimation of market shares, and an evaluation of existing competition in the market. Each of these aspects is now considered in turn.

### *Existing Participants*

83. Competing providers of veterinary diagnostic pathology in New Zealand include:
- Veterinary pathology labs;
  - Veterinary clinics with in-clinic analysers;
  - Off shore analysis;
  - Small operators; and
  - Human health labs (to some extent).
84. The majority of veterinary diagnostic pathology services are currently provided by either Alpha or Gribbles. Both of these labs offer a comprehensive service by providing the ‘full suite of services’. That is, they offer a complete range of tests. A number of smaller operators currently provide one or two tests, servicing selected market segments.
85. Human pathology labs offer a number of tests, concentrating on blood testing, and around a third of veterinarians have in-clinic analysers which can do a range of basic tests.

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<sup>8</sup> For example, where market share measured in terms of capacity produces a significantly lower share of the market in the hands of participants than a measure in terms of sales volumes, the constraint on a combined entity from that unemployed capacity might be taken into account when identifying near entrants or the constraint from new market entry. In some cases, the model of market power being used may influence the choice as to which market share measure is used.

*Inter-firm Relationships*

86. Companies that are part of the same corporate grouping, or that have similar strong relationships, cannot be relied upon to provide an effective competitive constraint to one another. Other less formal relationships between companies may also give rise to limitations on the extent of rivalry between them. Relationships between persons in the relevant market and other businesses may also affect rivalry in a market.
87. Commission staff have not identified any such relationships in this industry.

*Imports*

88. In markets where imports are present, the Commission will consider whether actual competition from imported products is the equivalent to that from domestic supply. In undertaking this evaluation, the Commission will take into account the existence of any limits on quantities of imported product (the price elasticity of supply), and the effects on trade of various factors. Imports channelled through the parties to an acquisition, or persons associated with them, will be added to their domestic production in assessing market share, rather than being treated as independent sources of supply.
89. Imports are becoming a more important feature of this industry with the ability to send results overseas and the import of in-clinic analysers. This is enhanced by technology, particularly the ability to send results electronically. Imports can be expected to play a more significant role post acquisition.

*Safe Harbours*

90. Once the relevant market has been defined, the participants have been identified, and their market shares estimated, the Commission's 'safe harbours' can be applied. Under these safe harbours, a business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:
- where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is below 70%, the combined entity (including any interconnected or associated persons) has less than in the order of a 40% share; or
  - where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%.
91. As noted below, market shares by themselves are insufficient to establish whether competition in a market has been lessened. Other relevant issues are discussed in later sections.

*Market Shares*

92. The Commission has decided to use turn over as its primary measure of market share and concentration as the most common and effective measure of market share. The resulting shares are shown in Table One.

**Table One: Market Shares in the New Zealand Veterinary Diagnostic Pathology Market**

<b>Diagnostic Laboratories</b>	<b>\$ Million</b>	<b>% Market Share</b>
Sonic Group	[ ]	[ ]
Southern Communities	[ ]	[ ]



Bay of Plenty Medlab	[ ]	[ ]
Waikato Vetlab	[ ]	[ ]
Elders	[ ]	[ ]
Gribbles	[ ]	[ ]
Alpha	[ ]	[ ]
<b>Merged Entity</b>	<b>[ ]</b>	<b>[ ]</b>
Taranaki	[ ]	[ ]
Northland Medlab	[ ]	[ ]
Northland Vet Lab	[ ]	[ ]
Veterinarians in practice	[ ]	[ ]
<b>Total</b>	<b>13.64</b>	<b>100</b>

93. With a market share of [ ] the proposed acquisition will breach safe harbours and, in most respects, represents a 2 to 1 change in market structure.
94. For the purposes of competition analysis the Commission has aggregated the market shares post acquisition. However, the Commission expects the post acquisition market share of the merged entity would be eroded over time due to the likelihood of new entry. Because it is difficult to predict exactly how market share might be eroded, the Commission will use the combined market share of the two entities for the purpose of analysis.
95. Market shares are insufficient in themselves to establish whether competition in a market has been lessened. It is the interplay between a number of competition factors, of which seller concentration is only one, that has to be assessed in determining the impact of a business acquisition on competition. Other competition factors include entry conditions; the presence of an aggressive, innovative or maverick firm; countervailing power of buyers or suppliers; rapid innovation in the market; and others. These are considered for the relevant market in subsequent sections.

*State of Existing Competition*

96. Market participants report that the market for veterinary diagnostic pathology is currently reasonably competitive with Alpha providing good competition to Gribbles. The Commission would not typically expect a large number of players in a small market, therefore it is not surprising that other players make up such a small portion.

97. [

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98. [

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99. Post transaction it is expected that Gribbles may gain many of Alpha's customers. As the major supplier, Gribbles will stand to gain from acquiring Alpha. However, customers are free to switch to new suppliers and the Commission expects many will seek alternatives post acquisition. The New Zealand Veterinary Association has informed Commission staff that it supports this argument.

### *Conclusion*

100. Post the proposed acquisition, Gribbles will have a market share that is outside of safe harbours. However, in considering whether the proposed acquisition will result in unilateral market power, the Commission will take a range of factors into account, these are discussed below.

## **CONSTRAINTS FROM MARKET ENTRY**

### **Introduction**

101. A business acquisition is unlikely to result in a substantial lessening of competition in a market if behaviour in that market continues to be subject to real constraints from the threat of market entry.
102. Where barriers to entry are clearly low, it will not be necessary for the Commission to identify specific firms that might enter the market. In other cases, the Commission will seek to identify likely new entrants into the market.
103. The Commission will consider the history of past market entry as an indicator of the likelihood of future entry. The Commission is also mindful that entry often occurs on a relatively small scale, at least initially, and as such may not pose much of a competitive constraint on incumbents within the relevant time frame.
104. As it noted in Practice Note 4, the Commission accepts that potential competition can act as a constraint on a firm which might otherwise be able to exert market power.
105. This element of competition analysis was discussed by the Court of Appeal in its decision of 21 December 2001 on the Southern Cross/Aetna case<sup>9</sup>. The Court of Appeal stated:

Market share is relevant to the level and significance of market power but it is not in itself the determinant of market power. What level of market power a firm has, as a result of its market share, will depend substantially on the levels of barriers to entry and expansion which apply to the market. If the barriers are low, a high market share is unlikely to result in an insufficiently constrained level of market power. Conversely, if the barriers are high, a high market share is likely to lead to such a result. The level of market share and the level of market power have no direct relationship in themselves. The levels of barriers to entry and expansion provide the linkage and must be brought to account when considering the level of a firm's market power. The lower the barriers to entry and expansion, the more an incumbent firm with a high market share is constrained from using its position in a supra-competitive way.

106. Elsewhere in its decision the Court of Appeal noted that "anything is capable of being a barrier to entry or expansion if it amounts to a significant cost or limitation which a person has to face to enter a market or expand in the market and maintain that entry in the long run, being a cost or limitation that the established incumbent does not face".

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<sup>9</sup> *Commerce Commission v Southern Cross Medical Care Society* (2001) 10 TCLR 269

107. Accordingly the Commission has given careful attention to those who could be strategically placed to enter the market, and to the costs they might face.

### **Barriers to Entry**

108. The likely effectiveness of the threat of new entry in constraining the conduct of market participants, following a business acquisition that might otherwise lead to a substantial lessening of competition in a market, is determined by the nature and height of barriers to entry into that market.

109. The Commission considers that, for the purpose of considering this issue, a barrier to entry is best defined as an additional or significantly increased cost or other disadvantage that a new entrant must bear as a condition of entry. In evaluating the barriers to entry into a market, the Commission will generally consider the broader 'entry conditions' that apply, and then go on to evaluate which of those constitute entry barriers.

110. It is the overall obstacle to entry posed by the aggregation of the various barriers that is relevant in determining whether entry is relatively easy or not, and therefore whether or not potential entry would prevent a substantial lessening of competition.

111. For entry to act as an antidote to a substantial lessening of competition stemming from a business acquisition, it must constrain the behaviour of the combined entity and others in the market.

112. As already noted, Alpha and Gribbles are the two main players in the veterinary diagnostic pathology market. However, the industry is characterised by a large number of fringe players, which operate successfully specialising in one or two tests to particular market segments.

113. To enter the market successfully, a new entrant requires a basic laboratory with basic testing equipment. This equipment can be purchased or leased. Industry participants estimate that comprehensive national entry into the market can be achieved for low capital cost relative to the potential rewards from gaining market share.

114. As already noted, the applicant submits that human health labs are potential near entrants into the veterinary diagnostic pathology markets. Human health labs use the same testing equipment as veterinary pathology labs to offer a range of tests which are generic to humans and animals.

115. To offer more extensive tests and comprehensive entry into the veterinary diagnostic pathology market, a human health lab would need to have access to a veterinary pathologist trained to read animal samples. Human health labs spoken to by the Commission indicated that current volumes and prices made full-scale entry unattractive [ ]. Furthermore, veterinary work is not core business for human health labs. However, some have already entered the market in a small way. Therefore, the Commission considers human health labs to be potential near entrants into the veterinary pathology diagnostic market.

116. To supply full veterinary pathology services, a lab must have access to a veterinary pathologist. New Zealand does not currently offer training for veterinary pathologists. Therefore, any participant in this market wanting to provide full veterinary pathology services must bid for these pathologists on the world market.

117. Industry participants note that veterinary pathologists are becoming easier to get in New Zealand due to overseas events bringing New Zealanders home, an improving exchange rate, and the extensive training opportunities offered by our large numbers of

livestock. Because pathologists are only needed for 20% of the work, industry participants state that a veterinary lab can operate successfully without a trained pathologist by either not offering pathology services or contracting out that work.

118. Massey University is known to have provided casual veterinary pathology services to labs in the past. [

] Labworks once employed a clinical pathologist whilst she was living in California (using email communications).

119. This relationship continued for more than a year. Alpha currently provides Histopathology services to Taiwan.

120. All entrants encounter the same costs and likelihood of employing a veterinary pathologist. Therefore, the Commission does not view the supply of veterinary pathologists as a barrier to entry.

#### The “LET” Test

121. In order for the threat of market entry to be such a constraint on the exercise of market power as to alleviate concerns that a business acquisition could lead to a substantial lessening of competition, entry of new participants in response to the exercise of market power must be likely, sufficient in extent and timely (the *let* test). If they are to act as a constraint on market participants following a business acquisition which might otherwise lead to a substantial lessening of competition in a market, entry must be relatively easy, or to put it another way, barriers to entry must be relatively low.

#### *Likelihood of Entry*

122. The mere possibility of entry is, in the Commission’s view, an insufficient constraint on the exercise of market power to alleviate concerns about a substantial lessening of competition. In order to be a constraint on market participants, entry must be likely in commercial terms. An economically rational firm will be unlikely to enter a market unless it has a reasonable prospect of achieving a satisfactory return on its investment, including allowance for any risks involved.

123. In general, it is the pre-merger price that is relevant for judging whether entry is likely to be profitable. That in turn depends upon the reaction of incumbents to entry in terms of their production volume, together with the output volume needed by the entrant in order to lower its unit costs to the point where it can be competitive.

124. The Commission is aware of at least one firm with plans to offer some and/or a full range of veterinary diagnostic pathology services in New Zealand. Industry participants note that they expect the proposed acquisition will create new opportunities for entry and make new entry more attractive in the future. [

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125. As well as a number of fringe competitors with the potential to expand their operations in the market, there are a number of large international firms with the potential and capacity to enter the market. The Commission considers that entry by at least one of these firms is likely within the next twelve months. [

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126. New entry into the New Zealand veterinary diagnostic pathology market is therefore considered likely.

*Extent of Entry*

127. If entry is to constrain market participants, then the threat of entry must be at a level and spread of sales that is likely to cause market participants to react in a significant manner. The Commission will not consider entry that might occur only at relatively low volumes, or in localised areas, to represent a sufficient constraint to alleviate concerns about market power.

128. Small-scale entry into a market, where the entrant supplies one significant customer, or a particular product or geographic niche, may not be difficult to accomplish. However, further expansion from that “toe-hold” position may be difficult because of the presence of mobility barriers, which may hinder firm’s efforts to expand from one part of the market to another. Where mobility barriers are present in a market, they may reduce the ‘extent’ of entry.

129. The number and size of market participants that have outlined plans to enter the New Zealand veterinary pathology diagnosis market suggests that the extent of entry in the short to medium term is likely to be significant, with a large proportion of Alpha’s current market share being contestable.

130. [

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131. The extent of new entry into the New Zealand veterinary diagnostic pathology market is therefore considered moderate to high.

*Timeliness of Entry*

132. If it is effectively to constrain the exercise of market power to the extent necessary to alleviate concerns about a substantial lessening of competition, entry must be likely to occur before customers in the relevant market are detrimentally affected to a significant extent. Entry that constrains must be feasible within a reasonably short timeframe from the point at which market power is first exercised.

133. In some markets where goods and services are supplied and purchased on a long-term contractual basis, buyers may not immediately be exposed to the detrimental effects stemming from a potential substantial lessening of competition. In such cases, the competition analysis, in a timing sense, begins with the point at which those contracts come up for renewal.

134. If prices increase, new entry (in addition to that by [                      ]), can take place relatively quickly at relatively low cost. A full laboratory with equipment can be established quickly. The industry is such that the knowledge of new entry would spread quickly creating a ready customer base for a new entrant. [

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135. The timeliness of new entry into the New Zealand veterinary diagnostic pathology market is therefore likely to be immediate.

### *Conclusion on Constraints from Market Entry*

136. The Commission concludes that the barriers to entry are low for the supply of veterinary diagnostic pathology services into the New Zealand market and that entry by new entrants is likely to be on a scale sufficiently timely to offset the unilateral market power potentially gained by the transaction.

### *Conclusion: Unilateral Market Power*

137. Upon further consideration of other factors, specifically potential competition from entry, the Commission concludes that while Gribbles will have a market share that is outside of safe harbours it will not gain unilateral market power.

## **SCOPE FOR THE EXERCISE OF COORDINATED MARKET POWER**

### *Introduction*

138. A business acquisition may lead to a change in market circumstances such that coordination between the remaining firms either is made more likely, or the effectiveness of pre-acquisition coordination is enhanced. Firms that would otherwise compete may attempt to coordinate their behaviour in order to exercise market power by restricting their joint output and raising price. In extreme cases, where all firms in the market are involved and coordination is particularly effective, they may be able to behave like a collective monopolist. Where not all firms are involved, and market share in the hands of the collaborators is reduced, coordinated market power becomes more difficult to exercise because of competition from the independent firms in the market.

139. In broad terms, successful coordination can be thought of as requiring two ingredients: ‘collusion’ and ‘discipline’. ‘Collusion’ involves the firms individually coming to a mutually profitable expectation or agreement over coordination; ‘discipline’ requires that firms that would deviate from the understanding are detected and punished (thereby eliminating the short-term profit to be gained by the firm from deviating).

140. When assessing the scope for coordination in the market during the consideration of a business acquisition, the Commission will evaluate the likely post-acquisition structural and behavioural characteristics of the relevant market or markets to test whether the potential for coordination would be materially enhanced by the acquisition. The intention is to assess the likelihood of certain types of behaviour occurring, and whether these would be likely to lead to a substantial lessening of competition.

### *Collusion*

141. “Collusion” involves firms in a market individually coming to a mutually profitable expectation or agreement over coordination. Both explicit and tacit forms of such behaviour between firms are included.

142. The structural and behavioural factors that are usually considered to be conducive to collusion are set out in the left-hand column in Table Two. The significance of these is explained more fully in the Commission’s *Practice Note 4*. The right-hand column of the Table then assesses the extent to which those factors are present, or are likely to be enhanced post-merger, in the New Zealand veterinary diagnostic pathology market. A high proportion of ‘yes’ responses would suggest that the market was particularly favourable to ‘collusion’; a high proportion of ‘no’ responses the reverse.

143. The table below assesses the expected post acquisition scenario of the merged entity Gribbles with a strong new entrant such as [ ]

TABLE Two

**Testing the Potential for ‘Collusion’ in the NZ Veterinary Diagnostic Pathology Market**

<b>Factors conducive to collusion</b>	<b>Presence of factors in the market</b>
High seller concentration	Yes – post acquisition Gribbles will have a large portion of the market. However, new entry is likely.
Undifferentiated product	Yes – the various tests are much the same with quality/timeliness being the main areas of differentiation.
New entry slow	No – there is a history of successful new entry.
Lack of fringe competitors	No – there are many fringe competitors both here and in New Zealand.
Price inelastic demand curve	No – demand for many tests is price sensitive. Some tests are less sensitive, but these are limited.
Industry’s poor competition record	No – there is no record of poor competition.
Presence of excess capacity	Yes – Machinery, but not for Veterinary Pathologists
Presence of industry associations/fora	Yes – the New Zealand Veterinary Association.

144. The assessment of the relevant structural and behavioural conditions in the New Zealand veterinary pathology market in Table Two suggests that the market is not particularly likely to be susceptible to collusion, even after the acquisition.

*Conclusions – Co-ordinated Market Power*

145. It appears unlikely that the proposed acquisition would materially enhance the likelihood of co-ordinated market power in the New Zealand market for veterinary diagnostic pathology post acquisition.

**OTHER COMPETITION FACTORS**

**Constraint from Buyers or Suppliers**

146. The potential for a firm to wield market power may be constrained by countervailing power in the hands of its customers, or alternatively, when considering buyer (oligopsony or monopsony) market power, its suppliers. In some circumstances, it is possible that this

constraint may be sufficient to eliminate concerns that a business acquisition may lead to a substantial lessening of competition.

147. Where a combined entity would face a purchaser or supplier with a substantial degree of market power in a market affected by the acquisition, the Commission will consider whether that situation is such as to constrain market participants to such an extent that competition is not substantially lessened.

148. Those entities with large contracts (such as the Animal Health Board and MAF) exhibit strong levels of countervailing power. Both entities have stated that they are in a strong bargaining position and have a strong degree of influence on price and quality of service. MAF has stated that it does not believe its position will be compromised post acquisition. [

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149. Smaller firms such as veterinary clinics currently have a moderate degree of countervailing power and are able to leverage price discounts by sending diagnostic pathology work to a variety of laboratories throughout New Zealand. Should the acquisition proceed, veterinary clinics will still enjoy a reasonable level of countervailing power for most tests given the range of alternative providers, such as human health labs, overseas providers, or machines.

150. The Commission concludes that countervailing power in this industry is reasonable.

## **OVERALL CONCLUSION**

151. The Commission has considered the probable nature and extent of competition that would exist in the market for the supply of veterinary diagnostic pathology services in New Zealand. The Commission considers that the appropriate benchmark for comparison is the purchase of Alpha by an independent firm.

152. The Commission has considered the nature and extent of the contemplated lessening. The proposed acquisition would result in the merged entity obtaining a market share which falls outside the Commission's safe harbour guidelines and essentially represents a 2:1 change which normally would cause the Commission significant concern. However, the Commission has also considered the nature and extent of the contemplated lessening, in terms of the competitive constraints that would exist following the merger from:

- existing competition;
- potential competition from entry; and
- other competition factors.

153. The Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in the market for veterinary pathology diagnostic services in New Zealand due to:

- Low barriers to entry;
- Likely competition from entry; and
- Countervailing power of consumers.

## **DETERMINATION ON NOTICE OF CLEARANCE**



154. Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the purchase of Alpha Scientific Limited by the Gribbles Group Limited.

Dated this 5th day of February 2003

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John Belgrave

Chair